No. 16037

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

T. F. KORHERR,

Appellant,

vs.

A. J. BUMB, Trustee in Bankruptcy of Mallard Pond Builders, Inc., Bankrupt,

Appellee.

BRIEF OF APPELLEE.

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BRIEF OF APPELLEE.

Statement of Pleadings and Facts as to Jurisdiction.

The respondent, A. J. Bumb, Trustee in Bankruptcy of Mallard Pond Builders, Inc., Bankrupt, has nothing to add to the Statement of Pleadings and Facts as to Jurisdiction set forth in Appellant's Opening Brief and concurs with such.

Statement of Case.

As indicated in Appellant's Statement of the Case in his Opening Brief, the factual background of the case is set forth in the Agreed Statement [Rep. Tr. p. 21 *et seq.*], and in the Findings of Fact [Rep. Tr. p. 7 *et seq.*].

Respondent has no quarrel with appellant's summary of the factual background of the case. However, it should be noted that Hansen-Sargent Lumber Company, whose stop notice was upheld by the Referee, was a materialman furnishing lumber for the construction of the 33 houses in

the tract being constructed by the bankrupt [Referee's Decision, Tr. of R. p. 2]. In contract, T. F. Korherr, the appellant, was found to be a contractor, furnishing not only materials but also labor in connection with the flooring of the houses in the tract.

Issue.

The issue as set forth in the last paragraph of page 4 of Appellant's Opening Brief is, of course, quoted verbatim from the Agreed Statement on page 5 thereof, and respondent has joined in the framing of said issue, which is as follows:

May a flooring contractor, who contracts directly with an owner builder to furnish labor and materials for flooring, on a project on which the owner builder does not have a general contractor, avail himself of the stop notice remedy provided by California Code of Civil Procedure, Section 1190.1(h) as to construction loan funds?

Comment of Appellant's Specification of Errors.

Respondent submits that appellant's specification of error entitled No. 5, set forth on page 5 of his Opening Brief, incorrectly states the holding of the Referee in his Findings of Fact and Conclusions of Law [Rep. Tr. p. 14] and in his Judgment [Rep. Tr. p. 17].

This 5th specification of error by appellant is stated as follows:

> (5) That appellant had no claim upon the building fund.

The Referee's Conclusion 2 and his Judgment, Item 2, indicate that appellant has no claim upon the building loan fund by virtue of the Stop Notice.

This qualification of no such claim or lien by reason of the Stop Notice is lacking in the 5th specification of error by appellant and distorts the actual ruling of the referee. Respondent submits the general creditors of the bankrupt do have a claim on such funds, and the appellant may very well qualify as a general creditor. However, the Referee held that there was no such claim by virtue of a stop notice remedy to which appellant was not entitled.

ARGUMENT.

I.

Introduction.

Respondent's position may be briefly summarized as follows: The Referee and District Court have ruled that the appellant is a contractor within the meaning of that term as used in Section 1190.1(h) of the Code of Civil Procedure of California setting forth the stop notice remedy on construction loan funds; that under said section, the contractor is excluded from such remedy, and therefore such remedy is not available to the appellant. The respondent contends that the Referee and District Court have not erred in the position they have taken in this controversy for reasons which are set forth hereinafter.

II.

Reply to Point I of Appellant's Argument.

The loan agreement involved in this case between the bankrupt and the lending institution provided that the building construction funds loaned should be used for those contributing to the work of construction.

In the case at hand, a substantial majority of the general creditors of the bankrupt were materialmen, laborers or original contractors who contributed to the construction. They, either through neglect, or because the remedy was not available, did not file stop notices. Nonetheless, under the provisions of the building construction loan agreement [Ex. A], they are no less entitled to share in such funds than the appellant who has filed a stop notice which the Referee and District Court found invalid. Nothing in the loan agreement indicates appellant occupies a superior position to that of the great majority of the general creditors who likewise helped in the construction of the bank-

rupt's houses. Yet it would appear appellant is in effect contending he should have a position superior to other creditors who aided in the construction solely by virtue of such attempted stop notice.

The appellant in fact received considerably more in payment of his total contract price from the bankrupt than did a number of other creditors prior to bankruptcy. The Sun Lumber Company, for example, a general creditor who furnished most of the lumber for the project, received much less of a percentage of its total contract price than did appellant. The Sun Lumber Company even now has a general creditor's claim of in excess of $20,000.00 against the bankrupt.

The Referee's decision, concurred in by the District Court, would result in the sum claimed by appellant under his stop notice being given over to the general creditor's fund, where it would be shared in by many other creditors who likewise aided in the construction of the bankrupt's houses.

III.

Reply to Point II of Appellant's Argument.

Appellant contends under Point II of his Argument in his Opening Brief that the legislative intent of Section 1190.1 requires the sustaining appellant's stop notice right. The Trustee is convinced no such legislative intent is indicated.

Appellant cites no authority for this proposition, and respondent has been unable to find such authority in support of his contention.

It is interesting to note that appellant's argument at this stage of the appeal differs widely from his position when he was presenting argument before the District Court on

his petition for review. Then, appellant contended the Referee had inaccurately found him to be a subcontractor. As the Findings and Judgment of the Referee clearly indicate his decision was that T. F. Korherr was a contractor, this argument has apparently been abandoned by the appellant now. The Trustee has always conceded a subcontractor under 1190.1(h) of the Code of Civil Procedure of California has a right to the stop notice remedy. However, this remedy is not available to a contractor as that term is used in said code section and in other sections of the Code of Civil Procedure dealing with mechanic's liens and stop notices.

The Agreed Statement [Rep. Tr. p. 21 *et seq.*], summarized on page 3 of Appellant's Opening Brief, indicates appellant was a licensed flooring contractor, who furnished labor and materials for the flooring of houses being constructed by the bankrupt by way of a contract made directly with the bankrupt. There was no general contractor.

Appellant was not a subcontractor as that term is used in the mechanic's lien and stop notice statutes of California. In *Hihn-Hammond Lbr. Co. v. Elsom,* 171 Cal. 570, 154 Pac. 12, at page 14 of the Pacific Reporter citation, the Supreme Court of California stated:

> ". . . The term 'sub-contractor' embraces all persons who agree with the original contractor to furnish the material and construct for him on the premises some part of the structure which the original contractor has agreed to erect for the owner."

In 32 Cal. Jur. 2d 614, Section 15, the meaning of the word "sub-contractor" is discussed as follows:

> "The right to a mechanic's lien is extended to subcontractors. Literally, a sub-contractor is one who

> agrees with another to perform a part or all of the obligation the second party owes by contract to a third party. As used in the mechanic's lien law, however, the word has a narrower meaning. It embraces all persons who agree with the *original contractor* to furnish material and construct for him on the premises some part of the structure the original contractor has agreed to erect for the owner. . . ." (Emphasis added.)

Obviously, then the concept of subcontractor as used in the mechanic's lien and stop notice sections of the California Code of Civil Procedure indicates a three-party relationship, the subcontractor dealing with the original contractor who in turn deals with the owner. The situation before the court is clearly otherwise, being a two-party relationship, the appellant dealing directly with the bankrupt.

Since appellant was not a materialman nor a subcontractor in his dealings with the bankrupt, he was a contractor in such relationship as determined by the Referee and District Court.

The law of California provides that one furnishing labor and materials by dealing directly with the owner-builder is a contractor within the meaning of that term as used in the mechanic's lien law of the state.

In Section 14 of 32 Cal. Jur. 2d 612, the meaning of the word "contractor," as used in California mechanic's lien law, is discussed as follows:

> ". . . In a general sense every party to any contract is a contractor, but the term as used in the statutes relating to mechanic's liens has a restricted meaning. It refers to one who, under contract with the owner, undertakes for a consideration to furnish the material, labor, and superintendence required in the improve-

> ment of the owner's premises, either in the erection of a structure thereon or in the alteration or repair of one in existence. 'Contractor' therefore means one who by his skill, labor or materials creates or improves the property of another. It includes a painter who contracts with the owner to paint a building and furnish the necessary materials. . . . *And one may be an original contractor though he has agreed to do only a part of the work required for the construction of a building.*" (Emphasis added.)

In a leading case, *Pugh v. Moxley,* 164 Cal. 374, 128 Pac. 1037, at page 1039 of the Pacific Reporter citation, the Supreme Court of California repeats this definition of the word "contractor" as used in the mechanic's lien laws of California, as follows:

> ". . . On the other hand, one may be an original contractor although he has agreed to do only a part of the work required for the construction of a building."

See also:

La Grill v. Mallard, 90 Cal. 373, 27 Pac. 294.

Clearly, the appellant, T. F. Korherr, was a "contractor" in his relationship with the bankrupt, and as that word is used, in accordance with California Supreme Court interpretation, in the mechanic's lien laws of California. He agreed to do a part of the work of constructing various residential structures, by contract entered into directly with the owner-builder, the bankrupt, and in accordance with such contract furnished labor and materials for such purpose, namely the construction of floors in said residential structures.

And equally clearly, the appellant, T. F. Korherr, was not a "subcontractor" as that term is used in the mechanic's lien laws of California.

The mechanic's lien laws, and the stop notice remedy are closely related and interdependent. Section 1190.1(a)-(h) of the Code of Civil Procedure dealing with the stop notice remedy refers back to Sections 1181 and 1184.1 of the same code which deal with mechanic's liens, utilizing the same categories of persons entitled to mechanic's liens for entitlement to the stop notice remedies, with one exception, contractors. Therefore, it is logical to assume the meaning given to these various categories under the mechanic's lien laws are carried over into the stop notice remedy sections of the Code of Civil Procedure. Section 1190.1(h) of the Code of Civil Procedure of California provides, in part, as follows:

> "Any of the persons mentioned in Sections 1181 and 1184.1, *except the contractor* at any time prior to the expiration of the period within which claims of lien must be filed for record, as prescribed by the provisions of Section 1193.1 of this code, may, in any instance in which the funds with which the cost of the work of improvements are, wholly or in part, to be defrayed from the proceeds of a building loan, give to the mortgagee, beneficiary under deed of trust, or assignee or successor in interest of either, or to any escrow holder or other party holding any funds furnished or to be furnished by the owner or lender or any other person as a fund from which to pay construction costs or arising out of a construction or building loan, a notice similar to the one provided for in subdivision (a) of this section, whereupon the person so given such notice under this section, may withhold funds to answer such claims and any lien that may be filed therefor, but shall be under no obligation to do so unless a bond is furnished as hereinafter provided." (Emphasis added.)

Section 1181 of the Code of Civil Procedure sets forth the categories of persons entitled to mechanic's lien claims. Such categories include "mechanics, materialmen, contractors, subcontractors, artisans" and many others.

Thus, all of these categories of persons entitled to mechanic's lien claims under Section 1181 are likewise entitled to the stop notice remedy provided by Section 1193.1-(h), with one very important exception, namely *the contractor*. Section 1193.1(h) clearly and explicitly states that the contractor cannot avail himself of the stop notice remedy.

Therefore, it follows that the appellant, T. F. Korherr, being embraced within the term "contractor," is not entitled to the stop notice remedy, and the Referee so held in his decision.

Appellant attempts to have the word "general" read into the meaning of "contractor" as used in Section 1193.1 of the Code of Civil Procedure of California. As already stated, there is not one iota of authority cited by appellant for such construction, nor can counsel for the trustee find such authority.

The meaning attributed to the word "contractor" as used in the stop notice remedy, Section 1190.1(h), and the companion subsection 1190.1(a), cannot be different from the meaning given to "contractor" as used in Section 1181, and to which section the stop notice Section 1190.1 refers. The word "general" as modifying "contractors" is not present in Section 1181 and the word "contractors" in that section includes all original contractors, namely those persons furnishing substantial labor and materials under contract made directly with the owner-builder, and include the appellant, T. F. Korherr.

IV.

Reply to Point III of Appellant's Argument.

Appellant argues that the phraseology of Code of Civil Procedure, Section 1190.1(h) requires sustaining of appellant's stop notice right. Trustee submits that court construction of the language contained in said section indicates the contrary. Sections 1190.1(a), (h) of the Code of Civil Procedure are derived from former Section 1184 of same code, which was superseded by such section (Deerings Code of Civil Procedure of California, 1949 edition, pp. 565 and 571). The phrase "the contractor" appears in both Section 1183 and Section 1184 of the Code of Civil Procedure, which were previously in effect before 1951, and these sections were replaced by new code sections. Section 1190.1 contains the bulk of former Section 1184, the latter being the section dealing with stop notice remedy prior to 1951.

Since the phrase, "the contractor," has been brought into the new Section 1190.1 from the previous Section 1184, and was likewise used in old Section 1183 of the Code of Civil Procedure, it is worthwhile to examine court interpretations of the meaning of such phrase, there being no indication the legislature, in using the same phraseology in adopting Section 1190.1, intended any new or different meaning to be given the phrase as interpreted in the earlier code section.

In *Pugh v. Moxley,* 164 Cal. 374, 27 Pac. 294, the Supreme Court of California indicated the phrase "the contractor" as used in former Sections 1183 and 1184 embraced the concept of an original contractor, one who had privity with the owner-builder and furnished substantial labor and materials by direct contract with the owner, and who did only a portion of the total work of improvement.

See also, *Russ Lumber & Mill Co. v. Garrettson* (1891), 87 Cal. 589, 25 Pac. 747; *Los Angeles Pressed Brick Co. v. Los Angeles Pac. Boulevard & Dev. Co.* (1908), 7 Cal. App. 460, 94 Pac. 775. Section 1184, the former stop notice remedy section, read in 1891 much as Section 1190.1 does now in respect to this phrase, as indicated by the following quotation of the old statute taken from *Russ Lumber & Mill Co. v. Garrettson* (*supra*) at page 748 of the Pacific Reporter citation.

> "Any of the persons mentioned in Section 1183, *except the contractor,* may at any time give to the reputed owner written notice. . . ."

Section 1183 referred to was the former section setting forth the categories entitled to mechanic's liens, a substantial part of this section now being found in present Section 1181 of the Code of Civil Procedure.

Trustee's counsel has been unable to find any appellate cases in California where other than materialmen, subcontractors or laborers have utilized the stop notice remedy, whether under former Section 1184 of the Code of Civil Procedure or under the present Section 1190.1. No case has been found where one qualifying as an original contractor utilized such a remedy with appellate court approval. Nor has appellant cited any such cases in his Opening Brief, nor, for that matter, at any time in his previous arguments before the Referee and the District Court.

V.

Reply to Point IV of Appellant's Argument.

Appellant maintains on pages 14 and 15 of his Opening Brief that whether or not appellant properly can rely on Section 1190.1(h) of the Code of Civil Procedure, he is a third party beneficiary to the loan agreement and thus has superior rights to that of the Trustee.

The answer to this is that the loan agreement gives the same rights to all who have aided and contributed in the construction and this would include most of the general creditors of the bankrupt. The trustee represents not only the bankrupt but the creditors as well, and particularly the general creditors. This is set forth in Section 47 of the Bankruptcy Act (U. S. C., Tit. 11, Ch. 5, Sec. 75).

Appellant would have the court disregard the rights of these general creditors, represented by the trustee, who contributed to the construction, in some cases to a considerably greater degree than appellant, with less reward prior to bankruptcy, though their claim on the loan funds are equal in status to that of appellant.

Furthermore, the stop notice remedy now being statutory, if appellant is excluded from such remedy, he cannot assert the right he is denied by the claimed position of third party beneficiary as this would defeat the obvious intent of the legislature in barring him from such remedy.

VI.

Since the Legislature Has Treated Original Contractors, Including General Contractors, as One Common Category for the Filing of Mechanic's Lien, It Is Logical to Interpret the Meaning of "Contractor" in Section 1190.1(h) as Including Original Contractors.

Section 1193.1(b) and Section 1193.1(c) provide a 60-day period of time for the filing of mechanic's liens of original contractors if notice of completion is filed, and only 30 days for other categories, including subcontractors, materialmen and laborers. Here is evidence of the treatment as one category of general contractors and all others who qualify as original contractors such as the appellant, in regard to the mechanic's lien remedy, in contrast to all other categories. The appellant, along with general contractors, is entitled to 30 more days in which to file his mechanic's lien claims as against materialmen such as Hansen-Sargent Lumber Company and other categories. Here we have clear legislative intent indicating that all persons embraced within the concept of contractor, namely original contractors, whether general contractors or otherwise, are being placed in one common category as to preferred treatment in the matter of time given in which to file mechanic's liens as against all other categories of lien claimants. It is logical to assume that, given this preferred position together with general contractors as to filing of mechanic's liens, the appellant, as an original contractor, along with general contractors, is embraced within the meaning of the phrase, "the contractor," as used in an exclusionary manner, in Section 1190.1(h).

Conclusion.

Therefore, the Trustee submits that the decision of the Referee, concurred in by the District Court, holding that the stop notice remedy is not available to the appellant as he is embraced within the meaning of the phrase "the contractor" as used in the exclusionary manner in Section 1190.1(h) of the Code of Civil Procedure of California should be upheld.

There should be no different meaning given the word "contractor" in Section 1190.1(h) of the Code of Civil Procedure than has been given it in the sections dealing with mechanic's lien remedy in such code where it is also found.

Respectfully submitted,

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